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MICHAEL RODAK, JR., CLE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1479

ETSON B. JEFFRESS,

Petitioner,

—against—

JOSEPH L. KRAMER and BEATRICE F. KRAMER,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR INTERVENOR-PLAINTIFFS-RESPONDENTS IN OPPOSITION TO PETITION FOR CERTIORARI

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Intervenor-plaintiffs, Joseph L. Kramer and Beatrice F. Kramer, submit this brief in opposition to defendant's petition for certiorari. The decision below (A1)[1] is reported at 490 F.2d 611.

Counterstatement of Questions Presented

1. Did defendant purchase his shares (a) more than six months before their later sale, when the issuer, Champion, adopted a resolution approving a stock-for-stock acquisition

1. Citations with the prefix "A" or "B" are to pages of the appendices to the petition.

of defendant's company, subject to further negotiation; or (b) within six months of sale, when the parties completed negotiations and entered into a written agreement?

2. Should defendant be relieved of liability under § 16 (b) of the Securities Exchange Act merely because his short-swing profit-producing sale was part of a public offering under a registration statement—especially where the offering had been delayed by the selling group in order that interim bullish developments would enhance speculative interest and, accordingly, the proceeds of the offering?

3. Should recovery be denied because defendant obtained his shares from Champion as the purchase price for defendant's company?

Summary Statement of the Case

Plaintiff Champion Home Builders Co., a public company, sues Etson B. Jeffress, a director and officer, to recover a short-swing profit under § 16(b) of the Securities Exchange Act. The suit followed a demand by respondents, stockholders of Champion, who were later allowed to intervene. Thereafter intervenor-plaintiffs assumed the burden of prosecuting this case, including the appeal to the court below.

After extensive written and oral discovery, intervenor-plaintiffs moved for summary judgment in Champion's favor on the issue of liability. Defendant cross-moved for summary judgment of dismissal on a variety of grounds. The District Court (Joiner, J.) denied plaintiffs' motion and granted defendant's, finding that more than six months had elapsed between the purchase of defendant's shares and

their sale on September 12, 1968 (B15). According to the District Court, defendant purchased his shares on February 21, 1968 when Champion's board of directors adopted a resolution approving acquisition of defendant's company for 105,000 shares of Champion stock, subject to later negotiation of other terms and the parties' entry into a definitive agreement (B20).

Unanimously reversing, the Court of Appeals held that defendant remained uncommitted and acquired no incidents of ownership in the shares until April 17, 1968 when the parties arrived at a written agreement embodying all the terms (A4-A9). The appeal court also found that the "transaction gave rise not only to the potential for speculative abuse but also to actual abuse" (A11). These findings are fully supported by the record,[2] as will now appear.

Date of Purchase

Shortly before February 21, defendant and two officers of Champion had a handshake agreement that Champion would buy defendant's company, Concord, for 105,000 Champion shares (4).[3] No other terms were arrived at. Nothing was signed. On February 21 the Champion board adopted a resolution (A6) which "approved" such an exchange of shares of the two companies and authorized designated officers of Champion to negotiate and execute with defendant "an agreement and plan of reorganiza-

2. Inasmuch as the record consists of pleadings, documentary exhibits, answers to interrogatories and testimony by deposition, the "unless clearly erroneous" rule, F.R.Civ.P. 52(a), has no application; and the Court of Appeals was free to make its own findings. 5A J. W. Moore, *Federal Practice*, ¶ 52.04.

3. Figures in parentheses, without prefix or suffix, refer to pages in the petition.

tion." Defendant had yet to sign any paper relating to the transaction.

Negotiations then ensued between the parties and their attorneys (10a, 14a; Exh. 2, pp. 6, 9).[4] The transaction was consummated on execution of a 25-page "Agreement and Plan of Reorganization" on April 17, 1968 (Exh. 3).

Thereafter, on June 19, 1968, defendant was first elected a director and officer of Champion (7a, 17a). Assertions in the petition (4-5, 16) that defendant had been treated as a major stockholder and an insider since the February 21 board meeting have no record support.[5]

In his Form 3 report to the SEC (pursuant to § 16(a) of the Exchange Act), defendant set forth that he acquired his Champion stock on April 17—not February 21 (Exh. 11). All of Champion's statutory disclosure documents likewise set forth April 17 and not February 21 as the purchase date (Exh. 10, Item 2; Exh. 9, p. 4; Exh. 6, p. 12).

Nature of the Purchase Transaction

In an effort to invoke the pragmatic test for "unorthodox" transactions, *Kern County Land Co.* v. *Occidental*

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4. Citations with the suffix "a" are to pages of the Appendix filed in the Court of Appeals.
   Exhibits are in a binder marked "Exhibits," filed in the Court of Appeals.
   Mr. Sullivan, the author of Exh. 2, represented Champion in the negotiations; and Mr. Young was his associate. Mr. Bontrager was defendant's attorney.

5. Defendant was invited to join the February 21 board meeting (4), but only for the discussion relating to his company (Exh. 8, pp. 3-4). From that date until June 19, the record does not disclose any contact between defendant and Champion except by way of negotiation and (on April 17) consummation of the purchase transaction.

Petroleum Corp., 411 U.S. 582, 593-5 (1973), the petition (2, Question (2); 4; 5; 9; 11; 14; 16) repeatedly asserts or insinuates that defendant's transaction with Champion involved a merger. In truth there was no merger—only a purchase of stock in exchange for stock. Defendant's company, Concord, after acquisition of its stock by Champion, continued to operate as a separate corporation (Exh. 14, p. 2; Exh. 6, p. 3).

Potential for and Actuality of Speculative Abuse

The pragmatic test, moreover, even if it applied, would not avail defendant.

Defendant wanted a substantial part of the price being paid for his company to be in cash (44a-45a, 81a, 94a, 99a-100a), but a cash payment would have had tax disadvantages (45a). The parties' solution was to have defendant quickly dispose of about 25% of his to-be-acquired Champion shares in a public offering by Champion and its principal shareholders (82a-83a, 101a). This would also serve to reduce defendant's proportionate stock ownership in Champion, a condition imposed by its other large shareholders (58a).

Defendant and the other insiders all expected the market price of Champion stock to rise (Exh. 2, pp. 1-2; 83a, 102a). Grenier, a Champion officer, was put in charge of dealing with the underwriters and timing the offering (46a-47a). He was expected by all the insiders, including defendant, to time the offering so as to maximize the proceeds (id.). Grenier did his best (id.; 82a-85a).

Accordingly, the offering was delayed in order to await an improvement in Champion's earnings, expected by rea-

son of the phase-out of dealers' incentive programs and the pick-up of sales of Champion's revised product line (84a-85a). Defendant testified that he expected a price rise, based on his own knowledge of Champion's operations and its planned expansion program (102a-103a). Thus, when the offering was ultimately made, the registration statement was able to report enhanced earnings for the latest quarterly period ended May 31, 1968: 36¢ per share as against 10¢ for the corresponding 1967 period (Exh. 6, p. 4).

Furthermore, on June 19, 1968, at a meeting which first seated defendant as a director, the Champion board voted to split the stock two-for-one (Exh. 4, pp. 1-2).

The offering, by prospectus dated September 5, 1968 (Exh. 6), was a resounding success. On April 17, 1968, when defendant required his Champion shares, Champion stock was trading at around $44 per share (5). The public offering brought about $37 per split share (Exh. 6, p. 1). Defendant sold 50,000 of the split shares, about 25% of his position, in the public offering (6). The rise in market price between April 17 and September 5, $15 per split share, benefitted defendant to the extent of about $750,000—at the expense of the investing public which thereby paid that much more for defendant's shares.

The Registration Statement

Petitioner urges that he should escape liability because he sold under a registration statement.

When the registration statement became effective, the speculative abuse, at which § 16(b) is aimed, had already occurred. Defendant's shares had been withheld from sale in a rising market, in order to exploit unrevealed bullish developments.

The registration statement, true or false, was quite incidental. Insofar as it had market impact, the more that it revealed of theretofore undisclosed and favorable corporate developments, the better it suited defendant's speculative purpose and program.

Reason for Denying the Writ

The liability imposed below could hardly be clearer, in terms of both the letter and the purpose of § 16(b). There is no sound ground for review by this Court.

POINT I

Defendant did not acquire his shares until April 17, 1968, within six months of sale.

A purchase within the meaning of § 16(b) occurs when the insider is committed to take and pay for the shares. *Booth* v. *Varian Associates*, 334 F.2d 1 (1 Cir. 1964), *cert. den.* 379 U.S. 961 (1965); *Stella* v. *Graham-Paige Motors Corp.*, 232 F.2d 299 (2 Cir. 1956), *cert. den.* 352 U.S. 831. The purchaser must have both the right and obligation to buy; both parties must be bound. *Stella, supra*, at 301. In this case no such commitment arose until execution of the April 17, 1968 agreement (Exh. 3), which was less than six months before the sale.

The District Court's ruling (B18) that the February 21 Champion resolution bound the parties is unsupported by any principle of contract law or other authority.[6] It is also

6. *Shattuck Denn Mining Corp.* v. *LaMorte*, CCH Fed.Sec.L.Rep. ¶ 94,429, p. 95,473 (D.N.Y. 1974), involving a similar directors' resolution, is a recent 16(b) ruling on the point, contrary to the District Court's in our case.

at odds with the later declarations of the parties, including defendant's Form 3 report to the SEC (Exh. 11), p. 4, *supra.*

Statements in the petition (4-5, 16) that defendant enjoyed insider status since February 21 are mere assertion. Defendant was a rank outsider until at least April 17; see footnote 5, *supra.* Until that date, furthermore, he had no shares to sell, even if it be assumed that he had access to inside information. Dating defendant's 13% stock ownership (4) from February 21 would, in effect, reduce the statutory quarantine from six months to four: Between February 21 and April 17, defendant's relationship to Champion was too tenuous to provide him with either the means or the opportunity to engage in the interdicted conduct.

POINT II

The purchase was "orthodox".

The petition (9) submits that the ruling below is inconsistent with *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973). This argument, which is central to the petition, rests on the assumption that defendant's purchase involved a merger. We have already seen, pp. 4-5, *supra*, that this is not so. Defendant bought his Champion shares with shares of his own company. It has repeatedly and uniformly been held that there is no distinction, for § 16(b) purposes, between a voluntary purchase of stock for stock as against one for cash. *Booth* v. *Varian Associates*, 344 F.2d 1 (1 Cir. 1964), *cert. den.* 379 U.S. 961 (1965); *Blau* v. *Lamb*, 242 F.Supp. 151, 155 (D.N.Y. 1965), *rev'd on other grounds*, 263 F.2d 507 (2

Cir. 1966); *cert. den.* 385 U.S. 1002 (1967); *Marquette Cement Mfg. Co.* v. *Andreas*, 239 F.Supp. 962, 966 (D.N.Y. 1965); *Fistel* v. *Christman*, 135 F.Supp. 830 (D.N.Y. 1955); *Stella* v. *Graham-Paige Motors Corp.*, 132 F.Supp. 100, 102-3 (D.N.Y. 1955), *aff'd* 232 F.2d 299 (2 Cir. 1956), *cert. den.* 352 U.S. 831; *Blau* v. *Hodgkinson*, 100 F.Supp. 361, 373 (D.N.Y. 1951).

Such a transaction presents none of the statutory ambiguity and consequent problems which confronted this Court in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), and were the focus of the decisions and commentaries cited in footnote 26 to the prevailing opinion. Defendant's voluntary transaction left him in precisely the same position that he would have occupied had he bought for cash—i.e., a 13% shareholder (4) and, soon thereafter, a director and officer of Champion to boot. He was under no compulsion to sell and could have avoided liability simply by postponing sale for another five weeks. "Instead," as observed by the Court of Appeals (A12), "he chose to maximize his profits as early as possible."

POINT III

The sale likewise was "orthodox" and was not rendered any less so because it was made under a registration statement.

Defendant's sale, like his purchase, was entirely voluntary. The time picked for the public offering was agreeable to all members of the selling group, including defendant (47a-48a). Defendant approved the offering as a Champion director (Exh. 4, pp. 1, 3-6). He signed the registration statement (Exh. 7, p. 2).

Defendant nonetheless contends that § 16(b) would be unfairly or inappropriately applied because the sale was under a registration statement.

We have already noted, pp. 5-6, *supra*, that the speculative abuse in this case lay in the timing of the public offering. With relation to the investing public, the damage had already been done when the registration statement with its bullish disclosures became effective. The registration statement helped, rather than hindered, defendant's use of inside information for personal profit. Why, then, should it have any exculpatory consequence?

There are, moreover, broad and compelling reasons that sale under a registration statement should not be given exemptive effect:

1. The Securities and Exchange Commission, although empowered to do so, § 16(b) last sent., has declined to provide any such exemption.

2. Section 16(b)[7] in terms applies only to securities that are registered under § 12 of the Exchange Act, 15 U.S.C. § 78(1). Issuers of such securities are subject to the recurring disclosure requirements of the proxy rules, Exchange Act § 14(a), 15 U.S.C. § 78(n)(a), as well as to the periodic reporting requirements of § 13 of the Act, 15 U.S.C. § 78(m). These provisions generally call for prompt and full revelation of significant corporate transactions and events. If revelation by registration statement were to be given exemptive effect, it would be difficult to distinguish revelation by proxy statement, by current Form 8-K report, by quarterly Form 10-Q report, by annual Form 10-K

7. As qualified by § 16(a).

report, and by other such filings and documents. § 16(b) would be virtually nullified by judicial fiat. At best, instead of the clear-cut sanction envisaged by Congress,[8] litigation to enforce the statute would be mired in *ad hoc* analyses of the truth and adequacy of the contemporary disclosures.

3. No disclosure document could realistically approximate the information available to an active corporate insider (like defendant in this case). For example, management's expectations as to future earnings and dividends, continually studied in the executive suite, seldom find their way into registration statements and other disclosure materials. Misuse of this kind of inside information is just what the statute is aimed at.

Recent decisions imposing § 16(b) liability for profit-producing sales under registration statements include *Brenner* v. *Career Academy, Inc.*, 467 F.2d 1080 (7 Cir. 1972), and *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Industries, Inc.*, CCH Fed.Sec.L.Rep. ¶ 74,421, p. 95,434 (D.Ill. 1974). We find no case, and defendant cites none, where a defendant was relieved of § 16(b) liability because the sale was under a registration statement.

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8. See *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 592-3 (1973).

POINT IV

In view of the potential for and actuality of speculative abuse, liability should be imposed even if the transaction was unorthodox.

Assuming, *arguendo*, that defendant has raised a substantial question as to whether his acquisition of Champion shares was a "purchase" or his sale was a "sale" within the intendment of § 16(b), there would still be no controversy to detain this Court because this case so plainly presents not only the potentiality for but the actuality of speculative abuse. See pp. 5-6, *supra*.

Passing defendant's contention that he acquired his shares under a corporate resolution which merely authorized further negotiations, the most that can be said for defendant's position, and indeed all that defendant asserts, is that one or both of his "purchase" or "sale" were "unorthodox." Conceding this, liability still follows merely because of the potential for speculative abuse. *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 593-5 (1973).

There is no need to go beyond the fact that defendant served continuously as an active director and officer of the issuing company for almost three months before the profit-producing sale.

POINT V

Champion's "unjust enrichment" is not a defense.

Section 16(b) was not enacted to redress corporate injuries but to protect the investing and trading public. *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, fn. 23 (1973). The statute places the recovery in the corporation merely as a matter of expediency. As stated in *Jefferson Lake Sulphur Co.* v. *Walet*, 104 F.Supp. 20, 23 (D.La. 1952), an early and frequently cited case for the proposition that a corporation cannot be estopped to enforce a § 16(b) claim:

> "In other words, in order to protect minority shareholders and the public who have no control over the management of the corporation, Section 16(b) uses the corporation as an instrument, sometimes an unwilling instrument, by which the officer or director is forced to disgorge his short term profits."

"Unjust enrichment" of the issuing company is commonplace in § 16(b) actions. It has never been held to relieve the insider of liability or in any way to mitigate his accountability. The leading case is *Magida* v. *Continental Can Co.*, 231 F.2d 843 (2 Cir. 1956), *cert. den.* 351 U.S. 972.

Defendant complains that a recovery will have the effect of altering his bargain by reducing the price which he was to get for the company he sold to Champion. This argument got short shrift in *Roth* v. *Fund of Funds, Ltd.*, 405 F.2d 421, 422-3 (2 Cir. 1968), *cert. den.* 397 U.S. 75 (1969), *and Schur* v. *Salzman*, 365 F.Supp. 725, 733 (D.N.Y. 1973).

CONCLUSION

The petition for a writ of certiorari raises no question meriting review by this Court and it should be denied.

Dated: April 19, 1974

Respectfully submitted,

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